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SUBJECT: Optimism Returning to Manufacturing Heartland of the Pearl River Delta

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¶1. (SBU) Summary: Things are looking up for Dongguan, the export manufacturing powerhouse at the heart of the Pearl River Delta. A year ago business leaders in the city raised dire alarms of impending factory closures and massive layoffs. During meetings last month, contacts told the Consul General that conditions have stabilized with export orders improving again and a tighter labor market. The local government has taken steps to help firms tap the domestic market, but industry leaders representing Hong Kong investors believe obstacles remain that will keep many firms focused on export sales. End summary.

Situation Stabilizing

¶2. (SBU) A year after dire predictions of factory closures and mass layoffs left local businesses and officials concerned about economic stagnation and social unrest, the economic outlook has dramatically improved in the export manufacturing center of Dongguan. Leaders of the Dongguan Association of Enterprises with Foreign Investment (DG FIE Association), whose members are mostly Hong Kong-invested companies, told the Consul General during an October 16 visit that the situation had now stabilized as indicated not only in Customs statistics but also in the association member surveys and recent sales results at the executives' own factories. Chu Kwok Kai, the association chair, pointed out that Dongguan's total export value for the January-September 2009 period was down approximately 21% from a year ago, but rising sales in recent months led the association to predict exports would finish the year down just 16-17%. Eddie Leung, the association's honorary chair, noted that comparing 2009 to 2008 wasn't very useful because 2008 was actually a very good year overall. He said that 2009 exports would only be down about 7% from 2007 (ref B).

¶3. (SBU) Leung further commented that expected factory closures around the Chinese New Year holiday had failed to materialize. The association had predicted that 3,000 - 4,000 factories would close by February-March 2009; but by the time March rolled around, it was clear that many companies had figured out how to survive the crisis

and were doing better. Leung said that official figures showed that about 2,000 firms had shut down in Dongguan but noted that the vast majority were very small companies.

¶4. (SBU) Other contacts in Dongguan share the view of the DG FIE Association. Dongguan Mayor Li Yuquan told the Consul General that the public impression that many FIEs had moved out of Dongguan or shut down during the global financial crisis was mistaken. He said the number of firms that had left Dongguan during 2008 was actually lower than in a typical year. Li emphasized that the Dongguan government at all levels had been proactive about helping companies survive the crisis.

¶5. (SBU) Vice President Liu Minzhong of Nine Dragons, the world's second largest paper company, said that his firm had chosen to close several manufacturing lines for maintenance around the end of 2008 because of the impact of the global financial crisis on sales. However, since February things have "pretty much returned to normal," he said. Whereas government officials had previously visited the firm every week to monitor its status during the crisis, Liu noted that the visits had stopped around June/July 2009. He explained that Nine Dragons had actually increased capacity by 20% between 2008 and 2009 but was still able to sell all its output, albeit at lower margins.

Labor Market Tightening

¶6. (SBU) Balance has also returned to Dongguan's labor market, according to Mayor Li. He said that once again it had become difficult for firms to recruit workers, which he said was typical

during the busy summer months from July to October. The DG FIE leaders echoed his comments, saying that layoffs had been fewer than expected during the downturn with many companies reducing hours instead of cutting employees. They reported that, with business improving again, many companies said they couldn't hire enough workers. Nine Dragons' Liu also indicated that turnover at the firm's factory had started to return to pre-crisis levels after dropping substantially during the early part of the year. He noted that many factories in Dongguan had reopened or resumed higher levels of production while some migrant laborers were choosing to stay in their hometowns due to strong local economic growth.

Domestic Market Growth Helping Some

¶7. (SBU) DG FIE Association leaders praised the Dongguan municipal government's recent exposition to help export manufacturers in the city to tap the domestic Chinese market (ref A). Chairman Chu said that association members were able to get exhibit space at the exposition free of charge and that the municipal government subsidized up to 50 percent of printing costs for promotional materials distributed at the event. However, Leung also noted the obstacles that make it difficult for many firms to transition away from reliance on export markets, especially value-added-tax rebates that continue to make export processing more profitable. He also pointed out that export manufacturers don't have the relationships they need to develop marketing channels within the domestic market.

¶8. (SBU) Nine Dragons, on the other hand, has become increasingly reliant on the domestic Chinese market as the global downturn has reduced export demand. Liu told the Consul General that exports had previously accounted for about 44% of revenue but now accounted for less than 10%. He said that business in less-developed parts of China, especially Guangxi and Hunan, was booming for the paper firm.

Double Transfer Gets Mixed Reviews

¶9. (SBU) In response to the Consul General's question on the progress of Guangdong's double transfer policy, which aims to move labor-intensive factories and migrant labor populations, Dongguan

Mayor Li emphasized that the policy benefited firms that transfer but no companies were forced to move. He said the policy was based on market rules and claimed that enterprises with investment worth RMB 100 billion (about US$15 billion) had already chosen to move to other cities in Guangdong. However, Leung of the DG FIE Association said that most companies were willing to stay in Dongguan despite government incentives to move. According to Leung, the government has been relatively hands-off about encouraging firms to transfer their operations except in the cases of specifically targeted industries like highly polluting electro-plating factories in the city center. Liu of Nine Dragons said that his firm's factories had not been affected by the double transfer policy because it qualifies as a high-tech industry due to its advanced industrial process. He emphasized that moving to less-developed areas would not make business sense because the firm depends on economies of scale to keep costs low.

CEPA Starting to Bring Service Industries

¶10. (SBU) The DG FIE Association leaders also reported that they had begun to see more Hong Kong investment in Dongguan in service industries, in part due to the expansion of the Closer Economic Partnership Agreement (CEPA) (ref D). Leung said that Hong Kong logistics firms, in particular, had been active in expanding into Dongguan. The association has added 20-30 new members from the logistics industry, he said, noting that they had formed a separate logistics industry association under the umbrella of the DG FIE Association two months earlier. In addition, Leung said the Hong Kong Chamber of Commerce in Guangdong had recently added an accounting sector sub-division to its organization. Medical and legal services firms, however, do not appear to be expanding into the area, according to Leung.

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